



**INVESTMENT DIVISION  
SUITE 6300  
U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, DC 20416**

Date: January 5, 2007

To: Licensed Small Business Investment Companies

From: John Wilmeth, Chief--Data Management Staff

Subject: Year-end Financial Reporting Requirements

Under §107.630 of the SBA regulations, each Licensee must file an Annual Financial Report, SBA Form 468, within three months from the close of its fiscal year. For example, if your fiscal year end is December 31, 2006, you must file Form 468 no later than March 31, 2007.

In accordance with §107.504(a), you must prepare Form 468 electronically using the Windows version of the Form 468 electronic reporting software provided by SBA. **SBICs with outstanding Participating Securities and/or Prioritized Payments must use the newly updated version 3.0 of the electronic reporting software, as discussed in Section 1 of this memo.**

This memo provides information concerning the Form 468 software and guidance on SBIC audit and financial reporting issues. Please review this material and provide your independent public accountant with a copy of this memorandum.

**Section 1: Which Version of the Software Should I Use?**

**Debenture and Non-leveraged SBICs** may continue to use version 2.0 of the electronic reporting software. Users of version 2.0 should already have downloaded and applied the software patch that was made available in February 2005. This patch contains current OMB form expiration dates and includes some technical modifications that address anomalies encountered when generating SBA Form 1031 data. If you have not already applied the patch, you must download it from [www.sba.gov/INV/extra](http://www.sba.gov/INV/extra). When you type this address, you will be asked for a user name and password. Enter “inv” for the user name and “software” for the password (do not include the quotation marks). When the web page loads, scroll to the icons labeled for downloading the patch and click the appropriate one (either the corporation or partnership form).

Debenture and Non-leveraged SBICs may elect to prepare Form 468 using the newly updated version 3.0 of the electronic reporting software (available for limited partnerships only). This version contains minor changes to certain line items in the basic financial statements, primarily to accommodate accounting changes affecting Participating Securities SBICs. If you want to download version 3.0, follow the instructions in the next paragraph. Debenture and Non-leveraged SBICs are not required to use version 3.0.

**Participating Securities SBICs** (including SBICs with outstanding Participating Securities and/or Prioritized Payments) must prepare Form 468 using the newly updated version 3.0 of the electronic reporting software. The changes contained in this version are discussed in Section 6 of this memo. Since all Participating Securities SBICs are organized as limited partnerships, SBA has made only a partnership form available at this time. Version 3.0 can be downloaded from [www.sba.gov/INV/extra](http://www.sba.gov/INV/extra). When you type this address, you will be asked for a user name and password. Enter “inv” for the user name and “software” for the password (do not include the quotation marks). When the web page loads, click on the icon labeled for downloading version 3.0.

If you are unable to download version 3.0 of the electronic reporting software, you may request a copy on CD-ROM by sending an email to the Investment Division’s mailbox at [sbic@sba.gov](mailto:sbic@sba.gov). Please type “Request for SBIC Reporting Software” in the subject line of your email and include in the body of the email your complete mailing address. If you would like SBA to send the software by Federal Express, please provide your FedEx account number.

**If you are upgrading an existing installation of the software, do not uninstall the current copy of the electronic reporting software until after you have installed the new version of the software and imported your existing data into the new version. Not following this sequence could result in the loss of your reporting data.**

Note that the Instructions for Preparation of the Form 468 and the Electronic Reporting Software Manual are also available at [www.sba.gov/INV/extra](http://www.sba.gov/INV/extra).

## **Section 2: Filing Requirements—SBA Form 468**

1. A complete filing of Form 468 consists of the data files created by the electronic reporting software; two printed-out sets of the financial statements and supplementary schedules (including the signed management certifications, one of which must have original signatures); and two copies each of the Operating Plan Update narrative (for Licensees with outstanding SBA leverage or commitments), the Independent Auditor's Report, and the Notes to Financial Statements.
2. Send the paper copies of the Form 468 to the following address: U.S. Small Business

Administration, Investment Division, Attention: Antoinette Shingler, 409 3<sup>rd</sup> Street SW, Suite 6300, Washington, DC 20416.

3. Transmit the Form 468 data files created by the electronic reporting package to the Investment Division via electronic mail or diskette. If you send the Form 468 data files via email attachment, please state in the subject line of the email whether the Form 468 is an annual, quarterly, or economic impact filing.
4. Under Section 315(a) of the Small Business Investment Act of 1958, SBA may impose a late filing penalty of \$100 per day for every day the report is late.
5. Where it is impractical to file the report within the prescribed time, you may request additional time. The request must be in writing and should be addressed to your area chief or assigned financial analyst in the Office of SBIC Operations. We must receive your request before the filing due date (see § 107.670 of the regulations). You may send extension requests by letter, fax or electronic mail (email is preferred). Our main fax number is (202) 205-6959.
6. Form 468 includes an unaudited schedule called "Economic Data for Portfolio Concerns" (page 22) which asks for information about the revenues, employees and tax payments of companies in your portfolio. If you need extra time to obtain the information needed for this schedule, you may file Form 468 without it and submit it separately when it is completed. Attach a cover letter to your hard copy filing of Form 468 saying that the Economic Data schedule will be filed separately. You may take up to two months beyond your normal filing deadline to submit the schedule (see §107.630(a) and (e) of the regulations). You do not need to request a formal extension as long as you file the remainder of Form 468 on time. When you have completed the Economic Data schedule, send your Form 468 data files to SBA a second time via electronic mail or diskette along with two paper copies of the schedule. **Note: The information provided in the Economic Data schedule is crucial to efforts by SBA and the SBIC industry to maintain support for the SBIC program. SBA will closely monitor compliance with this reporting requirement.**
7. Industry information shown on the Form 468 Schedule of Loans and Investments (page 11 in version 3.0 or page 12 in version 2.0) must be reported using NAICS Codes. The SBA no longer uses SIC Codes. You can find the NAICS Code for a given industry on the web at [www.census.gov/NAICS](http://www.census.gov/NAICS). Enter an industry description and click on the button titled NAICS Search on the left side of the page to find the NAICS Code for a given industry.
8. Mature funds that are no longer making new investments are reminded to comply with §107.590(c) which requires the submission of a wind-up plan to your assigned SBA financial analyst.

### **Section 3: Valuation Reporting**

1. Along with the paper copies of your SBA Form 468, please submit the valuation reports you prepare internally to support the valuations shown on Form 468 for each portfolio company. There is no SBA-mandated format for these reports.

### **Section 4: Conduct of the Annual Audit**

1. **Confirmations:** For Licensees with SBA leverage, auditors typically request that SBA confirm the outstanding balances. To allow us to answer these requests as quickly as possible, please send confirmations to the following address: U.S. Small Business Administration, Attention: Michelle Gierwatoski, 721 19<sup>th</sup> Street, 3<sup>rd</sup> floor, Denver, CO 80202.

Requests can also be faxed to Michelle Gierwatoski at (202) 481-4621.

Please note that the Denver office can confirm a Licensee's outstanding Participating Securities balance, but is not in a position to confirm the accumulated Prioritized Payments. SBA recommends that all SBICs with Participating Securities leverage complete the Prioritized Payment section of the Participating Securities Distribution Worksheet for this purpose.

2. **Auditing Standards.** Audits are to be performed in accordance with generally accepted auditing standards (GAAS). It is not necessary to follow government auditing standards.

3. **Auditor's Opinion.** The financial statements contained in the Annual Report, SBA Form 468, are to be the subject of the independent public accountant's opinion and must be referred to specifically in the opinion. SBA recognizes that various GAAP changes in recent years have resulted in several significant differences between SBA Form 468 and GAAP financial statements (including, but not limited to, the treatment of unrealized gain/loss, presentation of financial highlights, valuation of certain loans and investments, and treatment of Participating Securities, prioritized payments and SBA profit participation.). As a result, the financial statement presentation on Form 468, based on SBA's "Accounting Standards and Financial Reporting Requirements for SBICs" and this memo, may be considered an Other Comprehensive Basis of Accounting ("OCBOA") and auditors may elect to provide SBA with an OCBOA opinion rather than a GAAP opinion, with the auditor's report stating that the financial statements have been prepared in accordance with accounting practices prescribed or permitted by the US Small Business Administration. SBA has no objection to this practice provided there is appropriate footnote description of the SBA-GAAP differences.

4. **Special Reporting Requirement for SBICs.** Under Public Law 104-208, effective

October 1, 1996, the annual audit of an SBIC must include "a statement by the independent certified public accountant" that a Licensee's valuations were prepared in conformity with its SBA-approved valuation policy. This provision is included in section 310(d) of the Small Business Investment Act of 1958, as amended, and §107.503(e)(2) of the SBA regulations.

SBA has determined that this legal requirement can be satisfied through the use of an explanatory paragraph in the auditor's report on the Form 468 financial statements. For further information, please see section IV, paragraph B, of "Accounting Standards and Financial Reporting Requirements for SBICs". Please note that this requirement applies only to reports on SBA Form 468 and not to reports on any other financial statements that an SBIC may prepare.

### **Section 5: Accounting Matters – General**

1. **Financial Highlights.** SBA does not require "Financial Highlights" of the type described in AICPA Statement of Position 95-2.

2. **Organization Costs.** In accordance with AICPA Statement of Position 98-5 (issued April 3, 1998), organization costs of SBIC should be expensed as they are incurred. This accounting treatment applies only to organization costs, not to SBA leverage fees or partnership syndication costs.

3. **Investments in Flow-through Entities.** The Statement of Operations Realized (page 4P or 4C of Form 468) includes a line for "Income (Loss) from Investments in Partnerships/Flow-through Entities" (line 3). Investors in such entities typically use the equity method of accounting, under which the cost basis of the investment is adjusted at the end of each accounting period to recognize the investor's allocated share of earnings or losses, and the amount of the adjustment is included in the net income of the investor. However, SBA has determined that this method is not appropriate for investors such as SBICs, which account for their investments at fair value, and has changed its accounting guidelines accordingly.

Under SBA's guidelines, instead of using the equity method, Licensees with portfolio investments in flow-through entities must report these investments at their fair value in the Statement of Financial Position, with the difference between cost and value reflected as unrealized appreciation or depreciation. Any income or loss allocated to the Licensee may, if appropriate, be a factor in the Licensee's estimate of the investment's fair value, but such allocations are not recognized as income or loss in the Statement of Operations Realized; furthermore, the Licensee's cost basis is not adjusted to reflect such allocations. Licensees are to recognize income or loss when realized upon disposition or liquidation of all or part of their ownership interest. Income is also recognized when the Licensee receives a distribution from the investee, other than a return of capital (which does not result in the recognition of income, but is treated as a reduction of the Licensee's cost basis).

4. **Consolidation of Portfolio Companies.** For most SBICs, the reporting entity is the SBIC only (for exceptions, see section V, paragraph C, of “Accounting Standards and Financial Reporting Requirements for SBICs”). Portfolio companies should NOT be consolidated, consistent with the FASB’s deferral of the application of FIN 46 to nonregistered investment companies.

5. **“Blocker” Corporations.** Under §107.720(b)(3), an SBIC can receive SBA approval to form one or more wholly-owned corporations through which it provides financing to small businesses organized as LLCs, limited partnerships, or other flow-through entities, in order to avoid causing tax-exempt investors in the SBIC to incur unrelated business taxable income (UBTI). Under these circumstances, the SBIC should report its investment on page 11 (version 3.0) or 12 (version 2.0) of Form 468 under the name of the eligible small business that is the ultimate recipient of the financing. In a comment field, the SBIC should indicate the name of the blocker corporation through which it holds the investment.

## **Section 6: Accounting Matters – Participating Securities**

1. **Classification of Participating Securities under FAS 150.** The FASB has issued **FAS 150**, “Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.” SBA’s view is that this Statement requires the outstanding principal balance of Participating Securities to be reported as a liability. SBA has issued version 3.0 of SBA Form 468, which classifies outstanding Participating Securities as a liability to conform to this requirement. SBICs with outstanding Participating Securities leverage and/or Prioritized Payments must download version 3.0 (see Section 1 of this memo) and use it to prepare their December 31, 2006 financial reports.

2. **Treatment of Prioritized Payments and Leverage Fees.** In addition to the classification of outstanding Participating Securities as a liability, version 3.0 accommodates a number of other changes related to FAS 150. **“Earned” Prioritized Payments, Charges and Adjustments**, which an SBIC is obligated to pay to SBA based on its profits, will be reported as interest expense in the Statement of Operations Realized (line 11a). Any amount that is “Earned” but unpaid as of 12/31/06 will be reported on line 33b of the Statement of Financial Position. This presentation will require an adjustment to net income in the Participating Securities Distribution Worksheet; see Section 7 of this memo.

**“Accumulated” Prioritized Payments**”, which an SBIC is not obligated to pay, should not be accrued because of their contingent nature but should be disclosed in a footnote to the financial statements. Consistent with the characterization of participating securities as a liability, leverage fees from 2005 and later years that are associated with these instruments must be treated as deferred financing costs, not as syndication costs; SBA encourages (but does not require) reclassification of leverage fees paid in 2004 and earlier years. The summary of significant accounting policies accompanying the financial statements should

clearly describe the accounting treatment of leverage fees, including any differences between fees paid before and after December 31, 2004.

**3. Prioritized Payments and Profit Participation Not Subject to FAS 133.** SBA is aware that some SBIC accounting practitioners have considered whether the prioritized payment and/or profit participation features of the Participating Securities may be subject to the requirements of **FAS 133**, "Accounting for Derivative Instruments and Hedging Activities." This Statement, if applicable would require SBICs to report prioritized payments and profit participation potentially due to SBA as liabilities measured at estimated fair value. For the purpose of reporting to SBA on Form 468, SBICs should **not** treat potential SBA prioritized payments or profit participation as a derivative instrument per FAS 133. Prioritized Payments should be presented in accordance with Section 6, item 2 of this memo. Any actual profit participation that has been calculated as of December 31, 2006 and is payable to SBA as a required annual distribution by the May 1, 2007 payment date should be shown in the Statement of Financial Position on line 33c.

**4. Tax Identification Number.** If you have issued Participating Securities and are preparing a K-1 for SBA, our tax identification number is 53-0215587.

## **Section 7: Participating Securities Distribution Worksheet**

**1. Required Submission of Distribution Worksheet.** If you have issued Participating Securities, please complete and submit the Participating Securities Distribution Worksheet in addition to your SBA Form 468. You must use the worksheet to do the calculations required by §§107.1510 through 107.1560 at the end of each fiscal year, beginning with the first year in which you issued Participating Securities. Even if you have no profits as of the end of a particular year and will not be making any distributions, you must go through the applicable sections of the worksheet, such as the computation of Accumulated Prioritized Payments and Adjustments. Specifically, you should complete the following sections:

- ✍ The preliminary information at the very beginning of the worksheet (lines 1 through 5)
- ✍ Section I: Earmarked Profit (Loss)
- ✍ Section II: Liquidity
- ✍ Section III: Prioritized Payments
- ✍ Section IV: Profit Participation (Parts IV-1 and IV-2 only)

**2. Requirements for SBICs Making a Required or Optional Distribution.** If the Participating Securities Distribution Worksheet indicates you must make a required year-end distribution, or if you wish to make an optional distribution, please telephone or email both your SBA financial analyst AND Julie Stroh (202-205-7504, [julie.stroh@sba.gov](mailto:julie.stroh@sba.gov)) as soon as possible. SBA regulations require that you notify us (i.e., submit a completed distribution worksheet and any necessary supporting documentation) at least **10 business days** prior to any distribution. Required year-end distributions for Calendar Year 2006 must be made no

later than May 1, 2007. Also, be aware that Participating Security redemption payments made after November 1, 2006 will be applied on the February 1, 2007 Payment Date; redemption payments made after February 1, 2007 will be applied on the May 1, 2007 Payment Date.

3. **Requirements for SBICs Not Making a Distribution.** If the distribution worksheet shows that no distribution is required and you do not plan to make an optional distribution, submit your worksheet in hard copy only to: U.S. Small Business Administration, Investment Division, Attention: Julie Stroh, 409 3<sup>rd</sup> Street SW, Suite 6300, Washington, DC 20416.

4. **Downloading the software.** The distribution worksheet can be downloaded from [www.sba.gov/INV/extra](http://www.sba.gov/INV/extra). When you type this address, you will be asked for a user name and password. Enter “inv” for the user name and “software” for the password (do not include the quotation marks). Scroll to the Participating Securities Distribution Worksheet Software section at bottom of the page and click on the download button. **Please note that the current version of the software is Version 3.0. You must use this version if you have leverage drawn against a commitment issued by SBA on or after October 1, 2001. Older versions do not allow you to correctly enter the annual charge on such leverage. Also, if you have previously used older versions of the worksheet and now must switch to Version 3.0, you must enter all your current information in a new (blank) copy of Version 3.0 (you can open a previous worksheet in 3.0 and edit it, but it will still be in its original version, not in 3.0).**

5. **Calculation of “Earmarked Profit”.** If you had Earned Prioritized Payments, Charges and/or Adjustments during 2006, i.e. Prioritized Payments that you were obligated to pay to SBA based on your profits, please note that SBA is now requiring these amounts to be reported on Form 468 as interest expense in the Statement of Operations Realized, in accordance with FAS 150 (see Section 6, item 2 of this memo). However, for the purpose of completing section I-3 of the Participating Securities Distribution Worksheet, this interest expense must be **excluded** from year-to-date net income on line 1 to calculate Earmarked Profit correctly and avoid double-counting.

6. **Calculation of “Excess Management Expense”.** In the calculation of Excess Management Expense (section I-2 of the Participating Securities Distribution Worksheet), on line 5 you must enter the gross management fee computed under your approved management fee formula, before any offsets for fee income earned by Associates. If you report your management fee expense net of offsets on Form 468, please include a reconciliation of the gross and net management fee figures with your distribution worksheet submission. Note: If you have previously made one or more distributions based on distribution worksheets in which Excess Management Expense was calculated using a net management fee, you will not be required to restate those worksheets.

## **Section 8: Other Available Information**



1. Two accounting-related documents are available on the SBIC program web site <http://www.sba.gov/INV>: (1) Accounting Standards for SBICs and (2) Chart of Accounts for SBICs. These items were published in August 1999 as appendices to SBA SOP 10 06, "Oversight and Regulation of Small Business Investment Companies." Find them on the web site by clicking on "For SBICs". We encourage you to download and review these materials.
2. If you have any questions concerning SBIC accounting, financial reporting, or participating securities distributions, contact Julie Stroh at (202) 205-7504 or Carol Fendler at (202) 205-7559.
3. For questions concerning electronic reporting, contact Ed Watkins at (202) 205-7071.
4. For questions concerning Form 468 filing confirmations, contact Antoinette Shingler at (202) 205-6517.
5. For other matters, including valuation reporting, contact your Area Chief or account executive.